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No. 15-145

In the Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.,

Petitioner,

v.

DANIEL LEE RITZ, JR.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF *AMICUS CURIAE* ON BEHALF OF THE NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES IN SUPPORT OF PETITIONER

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INTEREST OF THE *AMICUS CURIAE*[1]

This *amicus curiae* brief in support of Petitioner is submitted by the National Association of Bankruptcy Trustees ("NABT"), a non-profit association formed in 1982 that is the premier national professional organization of bankruptcy trustees. Over 75% of the approximately 1,100 active chapter 7 bankruptcy trustees are NABT members.

The mission of the NABT is to support the work of its trustee members and to promote the effectiveness and integrity of the bankruptcy system. NABT is intimately familiar with the practical issues associated with chapter 7 cases and has a strong interest in ensuring that the United States Bankruptcy Code, 11 U.S.C. § 101 *et seq.* (the "Code" or the "Bankruptcy Code"), is interpreted and administered in a manner that promotes fair and honest conduct by debtors in the hundreds of thousands of chapter 7 cases assigned to NABT's trustee members each year.[2] But the NABT's

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[1] All parties have consented to the filing of this *amicus* brief. No counsel for any party authored this brief in whole or in part. No party and no counsel for any party made a financial contribution to the preparation of this brief.

[2] In the twelve month period ending September 30, 2014, 533,572 individual chapter 7 bankruptcy petitions were filed in the United States. *See* News Release, Administrative Office of the U.S. Courts, reprinted at http://www.uscourts.gov /statistics/table/f-5a/bankruptcy-filings/2015/09/30 (last accessed December 18, 2015). Allocated among the approximately 1,100 chapter 7 trustees, each chapter 7 trustee

mission is subverted, and the trust of debtors and creditors alike in the integrity of the bankruptcy system is compromised, when unquestionably dishonest debtors like the one in this appeal are allowed to discharge individual debts associated with their misconduct.

Chapter 7 trustees owe a duty and responsibility to all creditors to pursue and recover assets for the estate, including assets that have been fraudulently transferred through schemes such as the one employed by the debtor in this case. *See* 11 U.S.C. §§ 704(a)(1) (duty to liquidate estate assets); 544(b) (power to avoid transfers under applicable state laws); and 548(a)(1)(A) (power to avoid fraudulent transfers). Chapter 7 trustees can also seek to deny a debtor a general discharge if the debtor fraudulently transfers assets within a year of filing bankruptcy with the actual intent to defraud creditors. 11 U.S.C. § 727(a)(2)(A). Moreover, a debtor may not receive a discharge of any debt obtained by "actual fraud." 11 U.S.C. § 523(a)(2)(A).

But the narrow definition of "actual fraud" adopted by the Fifth Circuit would cripple the ability of chapter 7 trustees to discharge their duties and would create an opening for debtors to fraudulently transfer and later dissipate assets with impunity through well-timed bankruptcy filings. By interpreting "actual fraud" under section

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receives an average of nearly 500 new chapter 7 cases every year. This new caseload is in addition to chapter 7 cases still pending from prior years that have yet to be fully administered and closed.

523(a)(2)(A) as not applying to debtors who — without affirmatively making any false representations — fraudulently transfer assets with the specific intent to defraud their creditors, the Fifth Circuit's decision undermines the very foundation of the Bankruptcy Code.

This appeal is critically important to the NABT because the decision below conflicts with the Bankruptcy Code's discharge provisions and underlying policy and perversely rewards some of the most dishonest of all debtors. The following discussion explains that section 523(a)(2)(A) of the Code should not be construed to create a path for dishonest debtors to receive a discharge simply by not making false representations to the creditors they cheat.

SUMMARY OF THE ARGUMENT

The decision below, interpreting "actual fraud" in section 523(a)(2)(A) of the Bankruptcy Code as limited to instances where the debtor affirmatively makes a false representation, creates a dangerous loophole through which the boldest and most dishonest debtors can "game the system" and achieve a complete discharge by silently transferring assets to insiders or other co-conspirators and then manipulating the timing of their bankruptcy petitions. By refraining from making any false representations to the creditors they cheat and by waiting more than a year after they fraudulently transfer their assets to file bankruptcy, dishonest debtors can both prevent their cheated creditors from blocking the discharge of their individual debts under section 523(a)(2)(A) of the Code and also block their chapter 7 trustees and creditors from objecting to their general discharge under section 727(a)(2)(A) of the Code. Worse still, debtors who do not consume or otherwise dissipate fraudulently conveyed assets but, instead, convert them into exempt assets before filing for bankruptcy, will be able to keep such property from their targeted victims forever. *See* 11 U.S.C. § 522.

Conversely, the more expansive definition of "actual fraud" embraced by the First and Seventh Circuits, which recognizes that "actual fraud" includes fraudulent conveyances made with the actual intent to defraud specific creditors, forecloses such "gaming" and is consistent with the fundamental principle that discharge through

bankruptcy is reserved only for honest but unfortunate debtors who are worthy of a discharge.

ARGUMENT

THE FIFTH CIRCUIT'S DECISION CONFLICTS WITH THE BANKRUPTCY CODE'S FUNDAMENTAL PURPOSE OF PROTECTING "HONEST BUT UNFORTUNATE" DEBTORS AND UNDERMINES THE ABILITY OF CHAPTER 7 TRUSTEES TO ADMINISTER CASES EFFECTIVELY.

The phrase "actual fraud" as used in section 523(a)(2)(A) is not defined by the Bankruptcy Code and, accordingly, should be given its ordinary and customary meaning. *E.g., Perrin v. United States*, 444 U.S. 37, 42 (1979) ("A fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning."). The Restatement (Second) of Torts — which this Court referenced in *Field v. Mans*, 516 U.S. 59, 70 (1995), as "the most widely accepted distillation of the common law of torts" — recognizes that intentional interference with property rights can amount to fraud. *See* Restatement (Second) of Torts § 871 (1977) ("One who intentionally deprives another of his legally protected property interest or causes injury to the interest is subject to liability to the other if his conduct is generally culpable and not justifiable under the circumstances."). Similarly, Collier's leading treatise on bankruptcy does not

limit the definition of "actual fraud" in section 523(a)(2)(A) of the Code to instances where the debtor has affirmatively made a false representation, but, rather, states that "[a]ctual fraud, by definition, consists of any deceit, artifice, trick, or design involving direct and active operation of the mind, used to circumvent and cheat another — something said, done or omitted with the design of perpetrating what is known to be a cheat or deception." 4 COLLIER ON BANKRUPTCY ¶ 523.08[1][e] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2015). Thus, whether swindled by a debtor's affirmative misrepresentation or cheated by a debtor who transfers assets rather than pay his debts, creditors in both instances are victims of a debtor's "actual fraud."

The NABT is deeply concerned that the Fifth Circuit's narrow definition of "actual fraud" — limited to instances where the debtor has affirmatively made a false representation — effectively and unjustifiably insulates the silent schemer from adverse consequences that ought to flow from his misconduct. Such a restricted definition of "actual fraud" can render chapter 7 trustees and creditors powerless to stop dishonest debtors from transferring assets to their cronies at the expense of their creditors. Enterprising conmen who engage in elaborate, but silent, schemes to defraud their creditors will be able to exploit the bankruptcy system to preserve the fruits of their fraud and obtain a discharge of their debts — simply by not affirmatively making false representations to the creditors they defraud. These unscrupulous

schemers should not receive a discharge of debts they incur through elaborate machinations to cheat their creditors. *See Grogan v. Garner*, 498 U.S. 279, 287-88 (1991) ("[i]n the same breath that we have invoked this 'fresh start' policy, we have been careful to explain that the Act limits the opportunity for a completely unencumbered new beginning to the 'honest but unfortunate debtor'"); *Cohen v. de la Cruz*, 523 U.S. 213, 217 (1998) (the Bankruptcy Code "has long prohibited debtors from discharging liabilities incurred on account of their fraud, embodying a basic policy animating the Code of affording relief only to an honest but unfortunate debtor").

Consider the fraud perpetrated by Ritz, the debtor in the case currently before the Court. His company, Chrysalis Manufacturing Corp. ("Chrysalis"), owed nearly $165,000 to Husky International Electronics ("Husky") for unpaid goods. *See Husky Int'l Elecs., Inc. v. Ritz (In re Ritz)*, 787 F.3d 312, 314 (5th Cir. 2015). While the debt to Husky was outstanding, and without making a false statement to anyone, Ritz went to extraordinary lengths to render Chrysalis judgment-proof by causing Chrysalis to fraudulently transfer over a million dollars to multiple other Ritz-affiliated entities. After Husky sued Ritz seeking to hold him personally liable for the debt, Ritz filed a chapter 7 petition. *Id.* at 315. Husky responded by filing an adversary complaint seeking to declare its debt exempt from Ritz's general discharge under the "actual fraud" exception in section 523(a)(2)(A) of the Bankruptcy Code. Yet solely because Ritz did not

affirmatively make a false representation to Husky, the Fifth Circuit ruled that Ritz was entitled to a discharge of Husky's debt. *Id.* at 321 ("[W]e conclude that a representation is a necessary prerequisite for a showing of 'actual fraud' under Section 523(a)(2)(A). Because the parties agree that the record contains no evidence of such a representation, discharge of the debt at issue is not barred under this provision.").

In another case currently before this Court on a Petition for Writ of *Certiorari*, the debtor's misconduct followed a similar pattern. *See Sauer v. Lawson (In re Lawson)*, 791 F.3d 214 (1st Cir. 2015), *petition for cert. filed*, 84 U.S.L.W. 4 (July 24, 2015) (No. 15-113). The eventual debtor, Carrie Lawson ("Lawson"), formed a shell entity called Commercial Construction M&C, LLC ("Commercial Construction") shortly before a near $170,000 fraud-based judgment was entered against Lawson's father and in favor of Sauer Incorporated ("Sauer"). *Id.* at 217. After judgment was entered, and without making a false representation to anyone, Lawson's father transferred over $100,000 to Commercial Construction to keep those funds out of Sauer's reach. During the next year, and complicit with her father's scheme to defraud Sauer, Lawson transferred $80,000 from Commercial Construction to herself. Sauer later successfully sued Lawson for the fraudulent transfers in Rhode Island state court. Lawson responded with a chapter 13 bankruptcy petition, and Sauer sued to deem its debt non-dischargeable under section 523(a)(2)(A) based on

Lawson's actual fraud.[3] Noting that the Fifth Circuit had arrived at a different conclusion, *id.* at 216, n.1, and after an exhaustive analysis of the meaning of the phrase "actual fraud" at common law and the text and legislative history of section 523(a)(2)(A), the First Circuit held that "the 'actual fraud' exception to discharge under § 523(a)(2)(A) includes knowing receipt of a fraudulent conveyance where such receipt constituted actual (as opposed to constructive) fraud." *Id.* at 225.

Similarly, the Seventh Circuit has also addressed the meaning of "actual fraud" in section 523(a)(2)(A) in the context of a debtor's scheme to transfer assets with the actual intent to defraud a specific creditor. In *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000), the Plaintiff, Harold McClellan, sold machinery valued at $200,000 to the brother of the eventual debtor, Bobbie Cantrell ("Cantrell"). *Id.* at 892. After the debt had been paid down to $100,000, McClellan sued Cantrell's brother in state court to recover the balance and for an injunction to prevent the brother from transferring the machinery. While the lawsuit was pending but before an injunction could be entered — and without Cantrell making any false representations to anyone — the brother "sold" the machinery to Cantrell for $10. Cantrell, who "was colluding with her brother to thwart McClellan's collection of the debt," then turned around and sold the machinery for $160,000. *Id.* at 892. A year later, McClellan

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[3] Section 523(a)(2)(A) applies in chapter 13 cases. *See* 11 U.S.C. § 1328(a)(2).

added Cantrell as a defendant in his state court lawsuit against her brother, "claiming that her brother's transfer of the machinery to her had been a fraudulent conveyance." *Id.* Two years after that, Cantrell filed a chapter 7 petition, and McClellan sued Cantrell to deem his debt exempt from her general discharge based on actual fraud under section 523(a)(2)(A) of the Bankruptcy Code. Rejecting the narrow view of "actual fraud" later adopted by the Fifth Circuit, the Seventh Circuit concluded that Cantrell's collusion with her brother constituted "actual fraud" even though she did not make any false representations:

> No learned inquiry into the history of fraud is necessary to establish that it is not limited to misrepresentations and misleading omissions. "Fraud is a generic term, which embraces all the multifarious means which human ingenuity can devise and which are resorted to by one individual to gain an advantage over another by false suggestions or by the suppression of truth. No definite and invariable rule can be laid down as a general proposition defining fraud, and it includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated."

Id. at 893, *quoting Stapleton v. Holt*, 250 P.2d 451, 453-54 (Okla. 952).

The pattern in all of these cases is remarkable and unmistakable. Either for their own personal gain or to further a scheme orchestrated by another, these unscrupulous debtors engaged in elaborate machinations to transfer assets with the actual intent to defraud creditors. In each case, the last step was to file for bankruptcy and seek a general discharge of their debts, including the debts owed to the very creditors they intentionally cheated. Had these debtors filed for bankruptcy within a year of the fraudulent transfers of their assets, their chapter 7 trustees[4] could, and likely would, have filed complaints under section 727(a)(2)(A)[5] of the Bankruptcy Code seeking to deny their general discharge. But because the transfers occurred more than a year before their respective bankruptcy filings — with such delay no doubt due in large part to the debtors' efforts to hide assets and evade

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[4] Under section 727(c) of the Code, chapter 7 trustees have standing to object to a debtor's discharge. 11 U.S.C. § 727(c). Section 727 is not applicable in chapter 13 cases and would not have applied to Lawson.

[5] Under section 727(a)(2)(A) of the Code, a debtor can be denied a general discharge if the debtor

> with intent to hinder, delay or defraud a creditor . . . has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated or concealed — (A) property of the debtor, within one year before the date of the filing of the petition . . . .

11 U.S.C. § 727(a)(2)(A).

creditors — and may not have included transfers of the debtor's own assets, that relief was unavailable. Moreover, fraudulent conveyance actions under section 548(a)(1)(A) of the Bankruptcy Code[6] or under applicable state laws[7] would have been equally unavailing because, by all accounts, the fraudulently conveyed property was nowhere to be found.

The only recourse in these and similar cases is for the defrauded creditor to seek to exempt its debt from discharge under the "actual fraud" exception in section 523(a)(2)(A) of the Bankruptcy Code. But

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[6] Under section 548(a)(1)(A) of the Code, a

> trustee may avoid any transfer . . . of an interest of the debtor in property, or an obligation . . . incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily — (A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud an entity to which the debtor was, or became, on or after the date such transfer was made or such obligation was incurred, indebted. . . .

11 U.S.C. § 548(a)(1)(A).

[7] Under section 544(b) of the Code, 11 U.S.C. § 544(b), a trustee has strong-arm powers to avoid transfers that would be avoidable under applicable state law. *See, e.g. Leibowitz v. Parkway Bank & Trust Co. (In re Image Worldwide)*, 139 F.3d 574, 576-77 (7th Cir. 1998) ("under the strong-arm provision of the Bankruptcy Code, 11 U.S.C. § 544(b), the trustee can avoid any transaction of the debtor that would be voidable by any actual unsecured creditor under state law").

defrauded creditors will have no remedy if the "false representation" loophole recognized by the Fifth Circuit becomes a permanent fixture of the Code. The Fifth Circuit's decision turns the Code's objective of helping honest but unfortunate debtors on its head and perversely fashions a road map for dishonest debtors to become quite fortunate debtors. By transferring assets more than a year before filing bankruptcy and by carefully avoiding making any false representations, all their debts, including debts owed to the very creditors targeted by their now successful fraudulent schemes, would be discharged. The Seventh Circuit was correct in *McClellan* when it stated that such misconduct by debtors "is as blatant an abuse of the Bankruptcy Code as we can imagine. It turns bankruptcy into an engine for fraud." *McClellan*, 217 F.3d at 893.

The 850 trustee members of the NABT are charged with the responsibility of administering over four hundred thousand new chapter 7 bankruptcy cases filed each and every year. Their ability to do so is dependent, in large measure, on the honesty and integrity of the debtors that appear in the cases they administer. It is antithetical to the integrity of the bankruptcy system and undermines the ability of NABT's trustee members to effectively administer cases if unscrupulous debtors can escape responsibility for their misconduct simply by not making any false representations to the creditors they cheat.

CONCLUSION

For the foregoing reasons, the decision of the Fifth Circuit below should be reversed.

Respectfully submitted,

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